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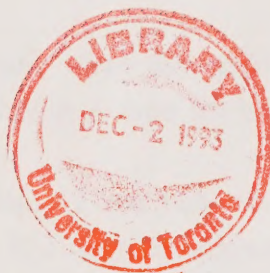
News Release

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Notes for an address by
The Honourable Paul Martin
Minister of Finance
at l'École des Hautes Études Commerciales

Montréal
November 29, 1993

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Ladies and gentlemen, students, faculty and friends.

Let me begin by thanking you for making time for me today. I would also like to thank l'École des Hautes Études Commerciales of the University of Montreal and the Faculty of Management of McGill University for organizing this event.

This is a season, I know, when the optimism that brought you to the study of business is severely tested. This is a time for exams.

I feel a certain kinship. I am now on the verge of completing my first month as Minister of Finance. If I may paraphrase a famous aphorism, nothing so wonderfully concentrates the mind as the feeling that the Department of Finance is slowly tightening around your neck.

The fiscal realities bequeathed to our new government are sobering indeed. And, that is what I would like to talk to you about today.

However, this is not the occasion for a detailed economic statement. That will come in my first budget, which I will deliver early in the new year. My concern is that I get that statement right. That is why I wanted to be here with you today, because as we begin to lay the foundation for the future, the choices we make as a new government will be the ones you, more than anyone else, will have to live with.

Thus, the process of consultation for the budget begins today.

First, however, the starting point.

Two weeks ago, I released the figures for the last fiscal year -- 1992-93. They showed a deficit of \$40.5 billion -- \$5 billion higher than the previous government had forecast would be the result.

For this fiscal year, which has but four months to run, the Conservative government forecast that the deficit would decline to \$32.6 billion. Unfortunately, this forecast is even further from reality than that of the previous fiscal year.

I would now confirm that the deficit for this year, the last fiscal year of the Conservative mandate, will be between \$44 billion and \$46 billion. This estimate is \$11 to \$13 billion higher than that forecast in their budget only six months ago.

That is the reality with which we, as a new government, must now deal. And we shall!

We are committed to deficit reduction. No-one should be under any misapprehension about that.

To those who would doubt our resolve, let me remind them that Prime Minister Chrétien's first action on his first day in office was to make the initial cuts in expenditures just as he had promised -- in the helicopter contract, in the number of cabinet ministers and in the size of their offices.

This is but the beginning.

The President of the Treasury Board has already begun the line by line review of existing government expenditures.

Given Canada's fiscal situation, it is important to re-state and to reconfirm two major commitments we made prior to last October's election.

First, we committed ourselves to put the economy back on a path of growth, and we will keep that commitment.

Second, we said that our interim target for the deficit was to seek to reduce it to 3 per cent of GDP in three years -- a target that has not been achieved in over a decade. Given the numbers that have just been announced, it will not be easy, to say the least.

But, let me assure you that that remains our target and it forms the basis of our ongoing budgetary planning.

As the Prime Minister said during the campaign, we are not going to use the books newly revealed to us as an excuse for inaction.

It is fair to ask, however, why the Conservative forecast was so far off from reality. There are several reasons, some more important than others. Let me set out just four.

First, the deficit is higher than forecast, because the previous government failed to provide for obvious contingencies. These items -- involving stabilization payments to the provinces and the GST low-income credit -- amount to about \$1.8 billion.

Second, it is now apparent that incomes were weaker in 1992 because of the recession and, unfortunately, the government did not factor this into its calculations of the spillover into 1993. This was reflected in about \$3.3 billion in higher personal income tax refunds than was forecast, and higher payments for the child tax benefit and the GST low-income credit.

Third, the growth of the underground economy, of which tobacco smuggling is a flagrant example. More and more people consider it acceptable not to pay taxes. We do not know the full extent of this phenomenon, but it is essential that we find out and deal with it in order to restore the fundamental basis of a healthy tax system -- the reality and the perception that everyone is paying his or her fair share.

You will note that throughout these remarks, I put a lot of emphasis on the need for a national consensus. The rise of the underground economy is not simply about taxes - - although that is part of it. It is what happens when the population of a country no longer believes that it is heading in a direction where all benefit.

The underground economy is not all smugglers. It is hundreds of thousands of otherwise honest people who have withdrawn their consent to be governed, who have lost faith in government. That is why over the next four years, one of the most

important things we can do is to re-establish the credibility of government and, to do that, we must restore control over the nation's finances.

The fourth and last reality is the persistence of the recession.

The fact is the previous government opted for forecasts that were far too rosy so it would not have to deal with the real fiscal and economic problems facing this country.

Last April, growth was forecast at 2.9 per cent for 1993. In fact, growth will be around 2.5 per cent. As well, the inflation rate was running at about half of what was expected, and this had a negative impact on incomes and hence on the tax base.

We are not talking here about a small amount. The difference between last April's forecast and that of today will add between \$4.5 billion and \$6.5 billion to the deficit.

To those who believe that the deficit can be cut without a commitment to collectively increase economic growth and to regain control of our finances, the numbers clearly demonstrate that they are wrong.

A detailed reconciliation of the reasons for the shortfall between the last Conservative budget and reality are provided in a document that is being made available today. The fact is, however, regardless of the reasons, no government, no organization can long operate effectively when its projections fall consistently short of the mark.

For this reason, the Department of Finance will be asking a team of outside specialists to review its forecasting methods and performance. This report will be reviewed by a steering committee including the Auditor General of Canada. We will make the report public as soon as we get it.

Better forecasts might not have changed the immediate result. But, in the long run, good forecasts lead to increased credibility and better policies. And that is what leads to better results.

As we address the situation today, it is important to keep in mind that the numbers I have just set out reflect where we have been, not where we can go -- not our potential, but our failure to achieve our potential.

Long before we came to office, we knew that increasing growth and cleaning up the nation's finances were what we had to do.

Yes, we start from further behind than we expected. How we move ahead, however, is our primary concern today.

If the Canada of tomorrow is to provide you with the jobs you have the right to expect, we as a nation must begin now to regain the will required to both recognize our problems and deal with them.

The feeling of disconnection Canadians have from their governments is a very real obstacle to this. If governments are going to succeed, we are going to have to change the way they deal with people or much of what governments try to do simply won't work.

That is why the Prime Minister has asked me to make sure that our first budget reflects as much public input as possible in the brief period of time before it is announced. Furthermore, this process of openness is to be the hallmark of all future Liberal budgets. We have to get Canadians involved in making the decisions that affect the fundamentals of their lives.

In the context of today's reality, we are deeply convinced that greater openness in the budget process is essential to achieving our policy goals. We are acutely aware that after a decade of so-called consultation exercises in which many voices rose and few could find their ideas reflected in the decisions of government, Canadians are rightly cautious.

That is why we will undertake a major new approach to consultation. We will do so in the brief period of time available between now and the next budget. And this, in turn, will be greatly expanded upon in the time leading up to the 1995 budget, one year hence.

If consultation is to work, there is a need for good, basic public information on what the government spends and how the government spends it. Just the facts! As soon as it can be prepared, my department will make public this data in accessible and usable form.

In December, I will invite leading economists from across the country to discuss Canada's economic prospects. The media will be invited. The debate over the right mix of monetary and fiscal policies must be taken out from behind closed doors if Canadians are to have a better understanding of the options and choices available to achieve their goals.

I have asked four independent and respected organizations -- the Institute for Reasearch on Public Policy, the Public Policy Forum, the Atlantic Provinces Economic Council and the Canada West Foundation to work with us to engage Canadians in the debates that lie ahead. This process of involvement is crucial if we are to build the national consensus so necessary to confront the decisions that lie ahead.

These organisations will bring together Canadians from all sectors to share their views and ideas on the challenges we face and the solutions we can consider. Officials from the Department of Finance will be there. So will I -- listening.

To focus public discussion, we will be asking Canadians to address a number of questions.

For example, what should governments do to foster growth, and what can business and labour do?

How do we take advantage of and preserve the low inflation environment for which we have paid so dearly?

How should we modernize many of our spending programs, and which ones should be addressed first?

And, how do we create a sense of national purpose and the will to regain control over the country's finances?

In other words, we will be looking for advice on the key questions we face in writing the upcoming budget. To that end, I will also be raising ways to open up the budget process, ways to better involve Parliament and its committees, ways to let Canadians buy into some of the most basic decisions that affect them.

Preparation for our first budget will, of course, include discussions with the provincial governments. They need to know our fiscal intentions and policy plans so as to undertake their own budgetary planning.

We need, too, to act more in concert in order to better confront our combined debts and deficits.

For this reason, tomorrow I will meet with provincial finance ministers in Halifax.

This is but the beginning of what must become a great national effort to face up to increasing government indebtedness and the need to create durable growth. Right across the spectrum of public issues, we need provincial co-operation in both substance and spirit. We are going to be working very hard to get it, and to offer our own co-operation in return.

Inevitably, differences will arise. That is the nature of the Canadian federation. But, we intend to ensure that such differences are the result of honest policy differences, rather than differences that arise from inadequate information, inadequate consultation and unkept commitments.

All this is a start, and nothing more than just that. However, I believe it is a start that we can build upon, in beginning to plug people and provinces back into the essential working of their national government. That is vital, not only because good public policy must rest on a solid fiscal basis, but also on an equally solid public consensus.

The need for national renewal is one deeply felt by the Chrétien administration. The government has begun its work on all fronts.

For example, the Minister of Human Resources is seeking to make investing in Canadians a modern reality, not simply a means of shoring up the failings of a series of disconnected government policies.

The Minister of Inter-Governmental Relations has said his goal is to bring government structure into the 1990s.

The Minister of Trade has stated that the great markets of Asia will form the basis of his new thrust, and the Minister of Industry has made it clear that small- and medium-sized businesses and the technologies of tomorrow provide the twin pillars of his new economic vision.

All of this activity will be reflected in our new budget.

Last week, the Minister of National Revenue announced tough new compliance measures. Such measures are necessary to ensure that those who owe taxes pay taxes. And that is only the beginning. We can, and will, do more to create a better tax system.

The government is already committed to replacing the GST as soon as possible with a fairer, simpler system. In the interim, we will be taking the steps necessary to reduce the administrative burden of the tax in order to make it easier for Canadians to comply.

When Parliament resumes, we will be asking the House of Commons Standing Committee on Finance to develop options to deal with the GST.

We will also be embarking on a comprehensive process of federal-provincial consultation to ensure that the replacement for the tax rests on a broad public and intergovernmental consensus.

Let me turn, finally, to what lies beyond the budget and to where my remarks began - with an essential optimism about the kind of Canada that remains possible despite our problems. It is there to be created. But, something more is needed than optimism.

This country was brought together by shared enterprise, public and private, East and West. It needs to be brought together again.

Until recent years, government was the catalyst in providing that direction -- sometimes right, sometimes wrong, but there.

What is needed now, and what has been lacking, is a broad sense of direction and commitment, a shared sense of enterprise and achievement. It is time to take our future in our hands.

Setting that direction involves listening to people and recognizing opportunities, and providing the supportive policies that will allow Canadians to take advantage of them.

That is what we came to government to do.

Nothing I have seen so far has changed my belief that this is where the main chance lies for a better future for all of us.

Now, I have talked a lot today about debt and deficits. All the arithmetic of a prolonged recession. But, this government will never be immune to the pain, the human tragedy that lies behind the numbers on the nation's balance sheet. The restoration of hope and the restoration of jobs must begin. It begins with our commitment to action and to dialogue at every step of the way. That is why I wanted to be here with you today.

Now, let us talk.

DEFICIT OUTLOOK FOR 1993-94

Changes since April 1993 Budget

(\$ billions)

A. April 1993 budget deficit forecast	32.6
B. <u>Changes due to:</u>	
1. Failure to pass legislation and to adequately provide for contingencies:	
- Failure to implement previously announced measures	0.6
- Stabilization claims	<u>1.2</u>
- Total	1.8
2. 1992 Income and Taxation Developments:	
- higher refunds/lower taxes owing on filing	1.8
- instalment payments	0.9
- Child Tax Benefit/ GST low-income credit	<u>0.6</u>
- Total	3.3
3. Higher Refunds:	
- Faster processing of PIT refunds	1.2
- Resource allowance court settlement	<u>0.5</u>
- Total	1.7
4. 1993-94 Economic Developments:	
- Personal income tax	1.1 to 1.5
- Corporate income tax	0.7 to 1.0
- GST	0.7 to 1.0
- Other excise taxes/duties	0.7 to 1.0
- Tobacco smuggling	0.4 to 0.6
- Other	<u>1.0 to 1.5</u>
- Total	4.6 to 6.6
	=====
5. Total change	11.4 to 13.4
C. Current Outlook	44 to 46

DEFICIT OUTLOOK FOR 1993-94

- The deficit for 1993-94 is now expected to be \$11.4 to \$13.4 billion higher than forecast in the April 1993 budget. The higher deficit outlook is attributable to a number of factors:
 1. Failure to pass legislation and to adequately provide for contingencies;
 2. 1992 income and taxation developments;
 3. Higher Refunds; and,
 4. 1993-94 economic developments.
- 1. Failure to Pass Legislation and to Adequately Provide for Contingencies
 - The April 1993 budget did not adequately reflect the costs of certain inevitable developments.
 - The April 1993 budget proposed that the low-income GST credit be paid semi-annually instead of quarterly, effective 1994, with the first payment being made April 1994. This would have resulted in a one-time cash saving to the government of \$625 million in fiscal year 1993-94, as the January 1994 would have been combined with the April 1994 payment. However, legislation to effect this change was not passed prior to the election.
 - The April 1993 budget did not fully provide for the potential claims under the Stabilization program. Under this program, a province may be eligible for an unconditional grant up to a maximum of \$60 per capita, with additional entitlements in a form of a five-year interest free loan, if it experiences a year-over-year

decline in its revenues due to economic developments. To date, eight of the ten provincial governments have submitted claims relating to declines in their revenues over the 1990-91 to 1992-93 period.

2. 1992 Income and Taxation Developments

- Preliminary 1992 taxation statistics, which became available recently, suggest that taxable income growth in 1992 was lower than estimated at the time of the April 1993 budget.
 - This has resulted in higher refunds being paid in 1993-94 and lower taxes on filing received in 1993-94 with respect to the 1992 taxation year.
 - It has also resulted in higher-than-expected payments under the income-tested Child Tax Benefit and Low-income GST Credit. Revenue Canada reassesses eligibility and the level of payments once a year, with payments being changed in July.
 - Revenue Canada has also informed about 300,000 quarterly filers, that based on their 1992 taxable income, they no longer have to pay their income taxes on a quarterly basis, beginning in September 1993. Instead, they will be remitting their 1993 taxes on an annual basis.

3. Refunds

- The Minister of Revenue Canada has announced that Canadians will be receiving their 1993 personal income tax refunds in record time, due to the acceptance of electronic filing and the introduction of three new single-sheet returns. This will result in an additional \$1.2 billion of refunds being processed in the February/March 1994 period, from that experienced last year in the same period.

- The Supreme Court of Canada's decision not to hear the government's appeal of certain income tax issues dealing with the taxation of resource allowances has resulted in substantially higher corporate income tax refunds in 1993-94.

4. 1993-94 Economic Developments

- Economic growth, both from lower real output and lower inflation, is estimated to be lower than forecast in the April 1993 budget, resulting in lower tax bases and therefore lower revenues. Real output is now expected to increase by 2.5% in 1993 and 3.0% in 1994. In the April 1993 budget, the growth rates were 2.9% and 4.6%, respectively. Inflation, as measured by the GDP implicit price deflator, is now expected to increase by only 0.8% in 1993 and 1.4% next year -- in the April 1993 budget, the increases were 1.6% and 2.4%, respectively. As a result, nominal income growth is now expected to be significantly lower than forecast in the April 1993 budget. And this lower growth in nominal incomes results in lower revenue growth for the government, across virtually all revenue sources. The tax bases are expected to be about \$15 to \$20 billion lower than forecast at the time of the last budget.
- Reduced sales of domestic tax-paid tobacco products will result in an additional \$0.4 to \$0.6 billion in lost revenues this year.
- The slower growth in the economy has also resulted in higher spending on programs sensitive to changes in the economy, most notably Established Programs Financing and unemployment insurance benefit payments.